

Universitas Brawijaya, Malang
Robert Van der Hoff

**Probable Impact of Law No. 22/1999 on Local Government
Administration and Law No. 25/1999 on Central-Local Fiscal Balance
(Dampak UU No. 22 tahun 1999 tentang Pelimpahan Kewenangan dan
UU No. 25 tahun 1999 tentang Perimbangan Keuangan)**

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Probable Impact of Law No. 22/1999 on Local Government Administration and Law No. 25/1999 on Central-Local Fiscal Balance

by Robert Van der Hoff

Introduction:

Law No. 22/1999 on Local Government Administration (UU PD) and Law No. 25/1999 on Central-Local Fiscal Balance (UU PKPD) were signed by the President on 7 May and 20 May respectively. Both laws provide for substantial improvements in decentralization over existing legislation; the UU PD much more so than UU PKPD. Both laws have been approved by a government whose legitimacy and credibility are in serious question. Thus, the probable impact of these laws depends heavily upon whether they will be rejected and/or substantially revised by a new government. It also depends upon to what extent the letter and spirit of the laws will be supported in the implementation regulations and guidelines to be issued and put into practice by a new government. With political commitment and hard work, these laws represent an opportunity to realize more genuine decentralization.

Law No. 22/1999 on Local Government (UU PD)

This law replaces Law 5/1974 on Local Government Administration and Law No. 5/1979 on Village Administration. Law No. 5/1974 was the first major New Order government commitment to the principle of decentralization and the intent to decentralize many functions of government to the local level. However, the law did not clearly define the responsibilities to be transferred, had no time frame for implementation and gave the central government ministries and Provinces too much control and discretion over the transfer of functional responsibilities. The dual role of Governors and Walikota/Bupatis as simultaneous heads of the autonomous local government functions and the representatives of the central government for deconcentrated functions (as well as the processes for electing the Governors and Walikota/Bupati) ensured the de facto continuation of central control. Despite these shortcomings, much progress was made in the transfer of functional responsibilities; improvements in the financial transfers to local governments to provide more flexibility, discretion and responsibility for own source revenues; and in building the management systems and human resources capabilities of local governments to accept greater responsibilities. Donor financed projects have contributed important and continuously to this progress.

Building upon this progress and responding to the widespread pressure for meaningful decentralization and political empowerment, but still within a unitary structure of government, the vital changes embodied in the new UU PD are:

- 1) Kota/Kabupaten (previously Kotamadya/Kabupaten, Pemda Tk. II) are fully autonomous and no longer report hierarchically to Provinces (previously Province. Pemda Tk. I).
- 2) While Governors still have a dual role, Walikota/Bupatis function solely as the head of the autonomous local government and are directly and solely responsible to the local parliament (DPRD).
- 3) Election process of Walikota/Bupati no longer requires the recommendation of candidates by the Governors or pre-approval of candidates by MOHA. Combined with fact that most DPRDs consist of a diversity of parties which will have to form coalitions, this means Walikota/Bupatis will become truly elected officials. Dramatic reorientation of Kota/Kabupaten executives toward priorities of local voters and empowerment of the public and DPRD are expected.
- 4) All functions not specifically assigned to central and provincial level government are (theoretically) assigned to Kota/Kabupaten. There will be major reassignment of previously Provincial tasks to Kota/Kabupaten. The Assignment of specific functions will be clarified in a PP currently being prepared with highest priority by Menko Wasbangpan.
- 5) Central ministries are no longer allowed to maintain offices (Kanwil) in the Provinces or (Kandep) in the Kota/Kabupaten for execution of projects/programs.

This law (if implemented in the specified 2-year time schedule, in accordance with its spirit, and if supported with appropriate financial resources) represents a major change in local politics and public administration, very much in line with Reformasi. Should a new national government be elected by the MPR in the November presidential election, it is probable that the features of this law are sufficiently reformist and dramatic that the concepts of the law, if not the law itself, would remain unaltered and implementable. The debate regarding transformation to a federal structure of government is expected to continue but it is likely that a new government would have other priority problems to overcome (coalition building, government reorganization, financial sector restructuring, etc) before undertaking such a transformation.

With such massive changes as envisioned on UU 22/1999, there will inevitably be both positive and negative results, if not some chaos. The positive aspects of empowerment of local communities and deconstruction of the top-down approach may be partially offset by short-term efficiency losses but these should not be insurmountable in the medium-term. Critics of UU PD who perceive the diminution of provincial government responsibilities as only a way to "divide and conquer" regional separatist aspirations fail

to anticipate the positive impact of the irreversible forces that are being let loose at the Kota/Kabupaten level through empowering both local governments and the public.

The fundamental risk of this rapid decentralization is that, rather than empowering the local people to ensure responsive and accountable local governments, it will lead to the establishment to "raja kecil" in the Kota/Kabupaten with KKN merely transferring from the central to local level. To preclude this, there is an urgent need to establish appropriate guidelines for local government management (especially financial planning and management) that clearly establish the role of the DPRD and people in providing direction and oversight of the local government administration and then provide capacity building to the DPRD and citizen groups to fill this role and responsibility.

To support the most effective practical implementation of the law UU PD, priority external technical assistance should include:

- Technical assistance to prepare, disseminate and implement supporting UU/PP/Kep Men/etc. (58 already identified for UU PD)
- Immediate support for training of Kota/Kabupaten DPRD members (12.000) regarding basic functions of local government. Local government and local government enterprise management. Role of DPRD versus role of the Kota/Kabupaten executive administration.
- Training of Kota/Kabupaten officials on new role, emphasizing public/customer-service orientation.
- Dissemination of UU PD to local communities.
- New processes for Kota/Kabupaten routine and capital budgeting including meaningful citizen participation and supervision by the DPRD.
- Major restructuring of personnel administration and career development systems related to local governments (>1.000.000 civil servants).
- Introduction of a credible local government audit capability; involving annual independent audits commissioned by DPRD.

Law No. 25/1999 on Central-Local Fiscal Balance (UU PKPD)

Replaces Law No. 32/1956 (never implemented) and the structure of local government financing that has evolved, essentially under central government ministerial discretion, ever since. The objectives of the new law were to provide sources of financial resources that are consistent with the devolution of responsibilities in the UU PD and retain a (difficult to define) balance between the often conflicting objectives of national equity and local autonomy. The law was intended to improve the adequacy and predictability of

financial resources for local governments (Provinces and Kota/Kabupaten) through improved transfers from central government and transfer of authority to local governments to raise own source revenues. These financial sources should provide more local discretion and autonomy through transparent mechanisms that engender local responsibility and accountability as well as stimulate local initiative. There is clear need to establish more transparent mechanisms for transfers which will reduce the existing central-local negotiations over transfers as 'formula-driven' as possible to make them more transparent, eliminate negotiations and make the levels of transfers more predictable than at presents.

Despite the inevitable risks of losing full control of fiscal policy that are inherent in fiscal decentralization, drafts of the UU PKPD as late as December, 1998 contained extensive use of set formulas to be specified in the law itself as well as transfers of specific tax authorities (e.g. rate setting and administrative responsibility for PBB property tax) to local government. However, with the GOI taking on an additional \$46 billion of external debt for the bank restructuring and safety net programs, combined with the fact that the needs of the local governments under the new UU PD were not yet clear, it was felt prudent to delay the devolution of any more fiscal authority than was absolutely necessary. MOF subsequently revised the draft law such that almost all transfers would be defined later by government regulations or other mechanisms, rather than being set by formulas in the law.

When this draft was submitted to the DPR many factions considered it objectionable; especially member from areas with substantial natural resource revenues. This led to a compromise where in specific formulae for sharing of property taxes (PBB / BPHTP) and some natural sharing of property taxes (PBB / BPHTP) and some natural resource revenue (oil, gas, mining, forestry, fisheries) were included. As a result of widespread lingering unhappiness over the negotiated settlement between MOF and the DPR (the legitimacy of which remains in unhappiness over the negotiated settlement question with much of the public), it is likely that the UU PKPD may be substantially changed if a new government is elected.

Despite the lack of substantive transfer of revenue raising authority directly to local governments, the new law does include the following very important improvements over the existing legislation (or lack of existing legislation) which would probably be further strengthened in a revision of the law and/or in implementing regulations and guidelines:

1. Elimination of the Subsidy Daerah Otonomi system for paying salaries of MOHA local government employees.

Rather than the current system of centrally-mandated staffing structures with salaries paid by SDO, local governments can design their own organizations to achieve administrative efficiency. Savings can be dedicated to other priority uses.

2. Combination of previous SDO allocations with Inpres block grants to form a General Allocation (Alokasi Umum) to be used with full local discretion.

This increased flexibility and discretion should allow substantial improvements in the allocation of funds to local priorities; especially to improve the balance between operations and maintenance expenditures and development expenditures.

3. Minimum General Allocations set at 25% of APBN Domestic Revenues.

4. Commitment to establishment of clear and transparent transfer formulas for General Allocations.

A Secretariat for Central-Local Fiscal Balance will be created under the DPOD to make recommendations for transparent General Allocation transfer formulae and annual allocations. The formulae will be approved by the DPOD which contains members from central ministries and representatives of Provinces and Kota/Kabupaten and is chaired by the Minister of Home Affairs.

5. Assignment in the law of specific proportions of PBB/BPHTP and natural resource revenues to be allocated to Provinces and Kota/Kabupaten from which the revenues originated.

6. Although not stated explicitly in either UU PKPD or UU PD, it is expected that the transfer of all technical ministry Kanwil to the Provincial governments and Kandep to the Kota and Kabupaten will result in substantial rechanneling of current DIP allocations to both the General and Special Allocations provided directly to local governments.

Priority areas for technical assistance to implement the law and/or revise it under a new government include:

- technical assistance to prepare, disseminate and implement supporting UU/PP/KepMen (17 already identified for UU PKPD).
- analysis of expenditure implications of the new assignment of responsibilities under UU Pemda and associated legislation.
- technical assistance to the Sekretariat for Central-Local Fiscal Balance, DPOD in the design and administration of new formulas for General Allocations.
- technical assistance for designing methodology for identifying and prioritizing Special Allocations needs of local governments while supporting maximum decentralization.

- design and implementation of new processes for Pemda routine and capital budgeting, including, meaningful citizen participation and supervision by the DPRD.